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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, DECEMBER 21, 1999

APPLICATION OF

COLUMBIA GAS OF VIRGINIA, INC.

CASE NO. PUE980287

For a general rate increase

FINAL ORDER

Before the Commission is the application of Columbia Gas of Virginia, Inc. ("Columbia" or "Company") for a general increase in rates. The Company also proposes major changes in its rate structure for residential and small commercial customers. As set out in the following paragraphs, the Commission will grant Columbia's application, in part, and approve an increase in annual revenues of approximately \$4.4 million. While the Commission will authorize some modifications, the Company's general rate structure for residential and small commercial services previously approved by the Commission will remain in effect.

On May 15, 1998, Columbia filed its application to increase rates to produce additional annual revenues of approximately \$5.2 million dollars over rates and charges proposed by the Company in its then pending Case No. PUE970455. On February 19, 1999, the Commission issued its Final Order in Case

No. PUE970455, in which we approved an annual increase in revenues of \$4,607,122. The Commission also referred several issues concerning propane services for disposition in this case.

Columbia moved for leave to amend its application on March 29, 1999, to introduce a new rate structure for its Residential and Small General Services. This proposed rate design would provide for recovery of non-gas costs through fixed monthly charges rather than through the combination of fixed and volumetric charges currently in effect. Hearings were held on June 9 and 10, 1999, to receive testimony and exhibits on various accounting and revenue issues, and on rates and charges, other than the proposed charges for Residential and Small General Services. Hearings were held on July 19 and 20, 1999, on issues arising from the proposed rate structure and on return on equity.

On July 16, 1999, Columbia and the Commission Staff filed a Stipulation and Recommendation addressing the revenue requirement, outstanding accounting issues, and issues concerning the Company's Metered Propane Service and Propane Delivery Service. The protestants in this case, Roanoke Gas Company and several industrial customers, did not object to the Stipulation and Recommendation. The Consumer Counsel, Office of the Attorney General, took no position on the proposed

disposition of issues related to the propane services, but otherwise did not object to the Stipulation and Recommendation.

The Report of Alexander F. Skirpan, Jr., Hearing Examiner (hereinafter "Report"), was filed on November 2, 1999. The examiner concluded that rates and charges designed to increase annual operating revenues by \$3.9 million, plus no more than \$516,000 to cover additional meter-reading costs, as proposed in the Stipulation and Settlement, were just and reasonable. The examiner found that the record did not support approval of Columbia's proposed rate structure for recovery of non-gas costs for residential and small commercial customers through fixed charges.

Columbia filed comments on the Report, which took exception to the findings on the proposed rate structure. As we will discuss below, the Company made a number of arguments supporting the proposed rate design, or in the alternative, significant increases in the current level of fixed monthly charges for residential and small general services customers. In its comments, the Consumer Counsel, Office of the Attorney General, supported the examiner's rejection of the proposed rate structure. The Staff filed brief comments addressing the narrow question of accounting treatment for annual informational filings.

Upon consideration of the record in this proceeding, the Report, and the comments on the Report, the Commission will adopt, with the limited exception discussed below, the Report and its findings and conclusions. With regard to the revenue requirement, the Commission agrees with the examiner that the increase in annual revenues proposed in the Stipulation and Recommendation is warranted. The Commission will approve an increase of \$3.9 million, plus no more than an additional \$516,000 to cover the anticipated additional cost of monthly meter reading. This additional revenue will enable the Company to render all monthly bills based on actual meter readings instead of its current practice of billing on the basis of estimates in alternate months. As contemplated by the Stipulation and Recommendation, the \$516,000 in additional revenues is a cap or maximum. The actual additional annual revenues may be less if the Company secures a price for the additional meter reading of less than \$0.25 per meter.

The Stipulation and Recommendation recognized the issue of whether the common equity return should be adjusted as a consequence of implementing the proposed rate structure for residential and small commercial customers. The examiner considered this issue at length in the Report. As addressed below in our discussion of the rate design, the Commission will increase customer charges to continue the progression to

recovery of non-gas costs independent of consumption level. The Commission finds, however, that this move toward increased monthly charges will not, in the circumstances of this case, have an impact on return on equity.

The Stipulation and Recommendation also included two accounting methodologies agreed to by the Company and the Staff, which the Commission adopts for future earnings tests. Columbia and Staff agreed to use a charge-off rate based on a six-year average to calculate uncollectible expense in future earnings tests. Likewise, the Company and Staff agreed to amortize over three years expenses related to a 1998 study conducted by Theodore Barry & Associates for earnings test purposes. We will direct Columbia to include an earnings test in its next annual informational filing for calendar year 1999, which will be filed with the Commission on or before March 30, 2000.¹ While the Commission has adopted these two accounting methodologies for earnings tests purposes, we do not here make a final determination of these issues for future ratemaking treatment. In this proceeding, the Staff also proposed an adjustment for

¹ By Order of March 31, 1999, in _____, Case No. PUE990168, the Commission waived Columbia's obligation to file an annual informational filing for the twelve months ending December 31, 1998, as required by Rule I(9) of the Rules Governing Utility Rate Increase Applications and Annual Informational Filings, 20 VAC 5-200-30. The Commission did require Columbia to file for 1998 an earnings test within seventy five (75) days of the date of the final order in this proceeding. That earnings test should be prepared in accordance with this Final Order.

the tax effect of the exercise of employee stock options. In the Stipulation and Recommendation, Company and Staff agreed that the issue would remain unresolved, and the Commission will not decide the matter.

Columbia's proposed fixed monthly charges for recovery of non-gas costs departs from the current rate structure. Columbia's rates and charges for Residential Service and Small General Service now divide costs between gas or commodity costs and non-gas costs. Gas costs are recovered through a purchased gas adjustment mechanism, and Columbia proposes no change in this methodology. Non-gas costs are now recovered through a combination of fixed customer charges and volumetric charges based on consumption.

In its amended application, Columbia proposed to recover all non-gas costs through fixed monthly charges. The fixed monthly charges would, however, be based on consumption. As proposed by Columbia, fixed monthly charges would vary with the customers' annual usage, and charges would be established for various consumption levels. (Report at 13-14.) As the examiner discussed at length in his report, there were a number of major problems with the proposal. The impact on customers of the breakpoints in the charges structure was a significant issue. Customers whose annual consumption differed by only a few MCF could be obligated to pay significantly different monthly

charges under Columbia's proposal. As the examiner noted, "[R]esidential customers with annual usage between 140 and 160 MCF may see their monthly charge vary between \$32 per month and \$67.45 per month depending on their actual weather-adjusted usage." (Report at 14.) Customers whose annual usage fell into the lower end of Columbia's proposed classifications would experience higher rates while customers with higher usage within proposed classifications would see a reduction in their rates. The record showed, however, that Columbia's costs of serving these residential and small commercial customers did not vary significantly from customer to customer. (Report at 24.)

As the examiner found, Columbia's proposed rate structure would result in significant rate shock. (Report at 19-23.) The examiner found that the average Columbia residential heating customer used 79.06 MCF. (Report at 15 n.120.) While Columbia and the Staff differed over the number of affected residential customers, they did agree that customers with annual consumption (0-10 MCF) significantly below the average would experience an increase in annual non-gas costs of 145.3 percent. (Report at 20, 21.) After considering the cost of gas, these same customers would, according to the Staff's calculations, still face an annual increase in total costs of approximately 115 percent. (Ex. JAS-46 at Attachment JAS 11, Page 2 of 2.) Even residential heating customers whose annual consumption (40-

50 MCF) approached the average would experience an increase in annual non-gas costs of approximately 30 percent. (Report at 20, 21.) These same customers would, according to the Staff's calculations, experience an annual increase in total costs of approximately 16 percent. (Ex. JAS-46 at Attachment JAS 11, Page 2 of 2.) At the same time, a small number of residential heating customers who use significantly more gas than the average would see their annual non-gas costs decline by approximately 70 to 90 percent and total costs decline by approximately 30 to 40 percent. (Ex. JAS-46 at Attachment JAS 11.) This level of change, absent extraordinary circumstances or emergency, should not occur. No amount of "customer education" effort can overcome the disruption caused by the level of increase proposed by the Company.

The examiner acknowledged, and we agree, that there are certain benefits to the Company from such a rate structure. Without the influence of weather, revenues would be more stable and predictable over time.

There is nothing in the record to suggest that the current rate structure of fixed charges and volumetric charges does not recover non-gas costs. The abandonment of volumetric charges would have two results. First, the timing of the collection of revenues to cover non-gas costs would be altered as essentially an equal amount would be collected every month of the year.

Currently, recovery of most of these costs is seasonal.²

Columbia contended throughout this proceeding that its proposed rate design is revenue neutral, i.e. total revenues recovered from the classes of customers to cover non-gas costs would not change. There would, therefore, be a redistribution in revenue contribution within the class. As noted above, the record establishes that some customers, particularly smaller volume users, would experience a significant increase in their total annual cost of gas service while other customers would see their annual cost of gas service decline. The issue before the Commission is whether the shift in timing and redistribution of burden is in the public interest.

Columbia maintained that this shifting in timing and burden is necessary to prepare for competition. We find little, if any, support for this contention in the record in this proceeding. While reducing or severing the linkage between weather and cost recovery may be a possible objective of rate design for a gas utility, the record in this proceeding suggests that there are other rate design objectives of equal or greater significance that must be considered. One such objective is the avoidance of rate shock. Given these competing considerations,

² Columbia currently offers several "Residential Budget Payment Plans" which allow customers to average or levelize their payments for gas service over the year. Participating customers pay approximately the same amount monthly. (Ex. JAS-46 at 4.)

the Company's proposed rate design is not necessary or desirable.

While the Commission declines to approve the proposal advanced by Columbia in this proceeding, we will continue our policy of gradual movement toward recovery of certain non-gas costs through the fixed monthly customer charge. This policy of incremental movement allows customers to adjust their consumption and to become familiar with an evolving rate structure while avoiding abrupt and, in some cases, significant changes that can lead to confusion and frustration.

The record in this proceeding includes cost-of-service studies conducted by the Company and the Staff using several different methodologies. The Commission appreciates that cost-of-service studies incorporate various methodologies over which there may be honest debate. Studies also reflect a variety of assumptions. While studies inform and guide the Commission, the results cannot be accepted categorically to establish rates. Accordingly, the Commission declines to adopt Columbia's argument for an increase in fixed charges based on the results of cost studies, as proposed in its comments on the Report.³

³ In its Comments and Exceptions of Columbia Gas of Virginia, Inc. at 14-15, the Company advocated a customer charge of between \$16.12 and \$20.70 for Residential Service and between \$35.60 and \$41.05 for Small General Service. In developing these ranges, Columbia used the results of its own studies as the upper end and the midpoint of two Staff studies as the lower end. The Staff's Demand/Commodity Study, however, supports a customer charge of

In this instance, the studies do support an increase in customer charges for Residential Service and Small General Service. The Commission finds that the record supports an increase in the Residential Service charge from \$10 per month to \$12 and an increase in the Small General Service customer charge from \$20 to \$23. These smaller increases will avoid the rate shock of the Company's proposal. With the increase in the customer charges, the volumetric charges will be reduced to assure that each customer class provides the same proportion of revenues. These adjustments to customer charges are an addition to the increase of no more than \$.25 per month to cover the additional cost of monthly meter reading.

The Commission will adopt the proposals for propane services included in the Stipulation and Recommendation. Specifically, Columbia and Staff agreed to remove the Company's cost of propane used in the Metered Propane Service from future purchased gas adjustment filings according to a formula and schedule set out in the Stipulation and Recommendation. In addition, Staff and Company proposed that the Metered Propane Service be opened to additional customers in the immediate vicinity of existing propane facilities and that Metered Propane Service customers remain on that schedule until they can be

\$13.79, for Residential Service and \$27.24 for Small General Service. (Ex. JAS-16 at 17.)

economically converted to natural gas service. With regard to Propane Delivery Service, Columbia and Staff recommended that the costs of converting individual customers to natural gas would not be included in above-the-line operating and maintenance expenses in any future filing. The Commission will accept these proposals in the Stipulation and Recommendation as well.

Finally, Columbia proposed to revise some of its Special Service charges in the proceeding. The Commission finds that these revisions should be accepted.

The Commission makes the following findings and conclusions based on the record in this proceeding and the Stipulation and Recommendation:

(1) The use of the test period ending December 31, 1997, is proper in this proceeding.

(2) The Company's test year operating revenues, after all adjustments, were \$190,443,501.

(3) The Company's test year operating revenue deductions, after all adjustments, were between \$168,589,242 and \$168,807,643.

(4) The Company's test year net operating income was between \$21,635,858 and \$21,854,259.

(5) The Company's test year adjusted net operating income, after all adjustments, was between \$21,388,518 and \$21,606,920.

(6) The Company's adjusted test year rate base was between \$267,603,156 and \$267,641,968.

(7) The Company's current rates produced a return on adjusted rate base of between 7.99 percent and 8.07 percent and a return on equity of between 8.84 percent and 9.00 percent.

(8) The Columbia Energy Group capital structure as of March 31, 1999, is appropriate for determining the Company's cost of capital in this proceeding.

(9) The Company's cost of capital is between 8.91 percent and 8.99 percent using the Columbia Energy Group capital structure as of March 31, 1999.

(10) The Company's cost of equity is within a range of 10.65 percent to 11.65 percent.

(11) The Company's application for an increase in annual revenues, as amended to the date of hearing, of \$9,194,322 would generate a return on rate base greater than 8.96 percent, and rates designed to recover those additional annual revenues would be unjust and unreasonable.

(12) The Company requires \$3,900,000, plus no more than an additional \$516,000, in additional gross annual revenues to earn a return on rate base of between 8.91 percent and 8.99 percent.

(13) Revised rates and charges designed to produce the additional gross annual revenues authorized herein shall use the

methodology for apportioning the increase among classes of customers proposed by the Company and agreed to by the Staff.

(14) The Company shall implement monthly meter reading within two months of the date of this Final Order.

(15) The current rate structure for recovery of non-gas costs for the Company's Residential Service and Small General Service shall be maintained; provided, however, that the Company may increase the Customer Charges for these services as discussed in this Final Order and make corresponding adjustments in the volumetric charges and further provided that the Company may also increase the Customer Charges by no more than an additional \$0.25 upon commencement of monthly meter reading.

(16) The Company should modify Section 17.6 of its General Terms and Conditions of its Gas Tariff to incorporate the formula in the Stipulation and Recommendation to eliminate the subsidy for Metered Propane Service commencing with the Actual Cost Adjustment Determination Period beginning September 1, 1999, and ending August 31, 2000, and thereafter.

(17) The Company shall revise its tariff provisions for Metered Propane Service to permit connection of new customers and to convert customers to natural gas service as discussed in this Final Order.

(18) The Company shall not include the costs of converting individual customers from Propane Delivery Service to natural

gas service in above-the-line operating and maintenance expenses in any future filings.

(19) The Company shall revise its Special Service Charges as proposed in its application.

(20) The Company shall refund, with interest, all revenues collected under its rates and charges which took effect under bond subject to refund and which exceed the revenues that would have been collected under the rates and charges approved in this Final Order.

ACCORDINGLY, IT IS ORDERED THAT:

(1) Columbia's application for a general increase in rates is granted to the extent discussed herein and otherwise denied.

(2) On or before January 4, 2000, Columbia shall file with the Commission's Division of Energy Regulation schedules of rates, charges, rules and regulations designed to produce \$3,900,000 in additional gross annual revenues and incorporating other revisions approved herein and bearing an effective date of, and effective for service rendered on and after, January 4, 2000. The additional revenues shall be apportioned using the methodology approved herein.

(3) Within sixty (60) days of the date of this Final Order, Columbia shall file with the Division of Energy Regulation revised tariff pages increasing Residential Service

and Small General Service customer charges by no more than \$0.25 and bearing an effective date of the filing date.

(4) Columbia shall file with its next annual informational filing required by Rule I(9) of the Rules Governing Utility Rate Increases and Annual Informational Filings, 20 VAC 5-200-30, an earnings test as discussed in this Final Order.

(5) On or before April 1, 2000, Columbia shall recalculate, using the rates and charges prescribed by ordering paragraph (2) of this Final Order, each bill it rendered that used, in whole or in part, the rates and charges that took effect under bond and subject to refund on October 13, 1998. Where application of the rates prescribed by this Order results in a reduced bill, Columbia shall refund with interest the difference.

(6) Interest upon the ordered refunds shall be computed from the date payments of monthly bills were due to the date refunds are made, at the average prime rate for each calendar quarter, compounded quarterly. The average prime rate for each calendar quarter shall be the arithmetic mean, to the nearest one-hundredth of one percent, of the prime rate values published in the Federal Reserve Bulletin or in the Federal Reserve's Selected Interest Rates (Statistical Release G.13) for the three months of the preceding calendar quarter.

(7) The refunds ordered in (5) above may be credited to current customers' accounts (each refund category shall be shown separately on each customer's bill). Refunds to former customers shall be made by check mailed to the last known address of such customers when the refund amount is \$1 or more. Columbia may offset the credit or refund to the extent no dispute exists regarding the outstanding balance of a current or former customer. No offset shall be permitted for the disputed portion of an outstanding balance. Columbia may retain refunds owed to former customers when such refund amount is less than \$1. Columbia shall maintain a record of former customers for which the refund is less than \$1, and such refunds shall be made promptly upon request. All unclaimed refunds shall be subject to § 55-210.6:2 of the Code of Virginia.

(8) On or before June 1, 2000, Columbia shall file with the Divisions of Public Utility Accounting and Energy Regulation a report showing that all refunds have been made pursuant to this Order and detailing the costs of the refund and accounts charged. Costs shall include, inter alia, computer costs, and the personnel hours, associated salaries and costs for verifying and correcting the refunds directed in this Order.

(9) This case is dismissed from the Commission's docket.